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Congress of the United States
Washington, DC 20515-6549

Policy Committee, White House Work to Repeal Double Tax on Savers and Retirees

December 4, 2002

Dear Colleague:

Today's *Wall Street Journal* reports that the White House is working to end the double tax on dividends.

At the beginning of the 108th Congress, I will reintroduce legislation I proposed to the President at the August Economic Forum that does so in the manner that benefits the most Americans most directly: by providing a shareholder credit for tax already paid at the corporate level. The credit method for ending double taxation is preferable to any of the others proposed. It is the method used by other major industrialized nations, and gives the maximum flexibility in dealing with foreign investors. It ensures maximum compliance, without requiring complicated, expensive changes in corporate financial statements. Most importantly, it ensures the benefits of relief go directly to individual shareholders.

It is important that Congress be ready with the best possible legislation when the Administration proposes dividends relief. To become an original cosponsor of the shareholder credit bill, or if you have any questions, please contact me or Charles Korsmo on my staff at 6-0687.

Sincerely,

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Christopher Cox
Chairman

THE WALL STREET JOURNAL

Tax Cut on Dividends Paid To Individuals Gains Support

By **JOHN D. MCKINNON**
Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON -- The White House is leaning toward proposing a sharp reduction of taxes that individuals pay on corporate dividends -- a move that could boost both the economy and the stock market.

Reducing the federal tax bite on corporate dividends, long a goal of Republicans and their business allies, would make dividend-paying stocks more attractive to individual investors. The tax breaks are bound to be attacked by Democrats as a costly sop to wealthy elites. But advocates say dividend-tax reductions would spur business investment and improve the stability of U.S. corporations by encouraging them to issue stock rather than borrowing money.

"In terms of bang for the buck [dividend-tax reduction] is really the biggest," said White House economic adviser Glenn Hubbard. According to a White House study, eliminating the tax could boost economic activity enough to allow the government to recoup as much as 40% to 50% of the cost -- estimated at up to $25 billion a year -- through increased tax payments. Mr. Hubbard and some other economists also argue that the proposal could boost overall stock prices by 20%.

Many business economists have argued that dividends are effectively taxed twice. Companies pay out dividends from the cash left after paying taxes on earnings; shareholders then must pay income tax on the dividends they get. By contrast, corporations can deduct payments on debt. So interest payments are taxed only when the holders of a company's debt report it as income -- for instance, as interest payments on corporate bonds.

The White House now is finalizing the package of tax proposals it intends to introduce by early next year. Business groups have been pushing the administration to slash corporate dividend taxes and to accelerate the date that other tax cuts take effect. Both proposals have become administration favorites. But a proposal by the Business Roundtable and some leading Democrats to suspend payroll taxes for the coming year has thus far been rejected, although it could re-emerge as part of a negotiated tax deal with congressional Democrats. Administration officials emphasize that President Bush hasn't yet approved a final package.

White House spokesman Ari Fleischer criticized the payroll-tax suspension because it would diminish funds earmarked for Social Security. Mr. Hubbard also disparaged the idea of any "temporary tax change" because it wouldn't fundamentally boost long-term economic growth. "The notion of a one-shot check having much of an effect is pretty far-fetched," he said.

Lawmakers, congressional aides and business advisers who have been briefed on the administration's tax plans say White House economic advisers are leaning increasingly toward slashing dividend taxes. Congressional aides who sat in on a briefing last week by Lawrence Lindsey, head of the White House's National Economic Council, say he left the impression that he favored investor tax breaks, a category that prominently includes the dividend plan. An administration official said Mr. Lindsey didn't intend to signal any policy preference.

However the debate isn't over within the administration. Treasury Secretary Paul O'Neill appears to be skeptical about a dividend-tax cut, in part, because he worries about the cost and thinks other tax breaks might be more effective in stimulating economic growth quickly. Of President Bush's top advisers, Mr. O'Neill may be the most concerned about the ballooning federal deficit and the most sanguine that the economy doesn't need much of an extra boost through tax cuts. The administration also is weighing other options to boost investment, including depreciation breaks and expanded retirement-savings accounts.

Higher Rates

Since dividends become part of an investor's income and are subject to income tax, wealthy investors pay higher rates on dividends than they would on capital gains. Over the years, corporations have focused less on dividend payouts and more on boosting stock prices. The pressure to show regular stock-market gains may have contributed to the corporate accounting scandals, some economists believe.

To end the so-called double taxation of dividends, the administration could eliminate, or deeply reduce, either the corporate or individual dividend tax. The White House hasn't made that choice yet, but it is more likely to focus on investors. That way it could sell the tax break as a measure to help a wide swath of the public, rather than a boon for American corporations. The option also is cheaper. About half of dividend recipients are tax-exempt entities, such as foundations and pension funds, which now don't pay dividend taxes. A new tax break wouldn't apply to them.

If approved, the plan could prompt changes at some big high-tech companies that have often resisted paying dividends. Shareholders of **Cisco Systems** Inc. recently voted down a proposal to require its leadership to consider dividends. But analysts said many shareholders likely would support dividends if they were tax-free.

A dividend-tax break would be included in a broader tax package, which also is likely to include an acceleration of tax cuts included in Mr. Bush's $1.35 trillion package. In a recent interview, Commerce Secretary Donald Evans said he preferred the faster phase-ins that were included in Mr. Bush's original tax plan but modified during congressional negotiations. That could include a faster phase-in of the expanded child credit, and faster relief from the so-called marriage penalty -- a set of quirks in the tax code that cause many married people to pay more in tax than they would if they were single.

Considering Acceleration

The White House also is considering accelerating the phase-in of scheduled rate cuts that largely affect middle- and upper-income earners.

Tuesday, Democratic Sen. John Kerry of Massachusetts, who is exploring a presidential run, endorsed the concept of dividend tax relief. But it is likely that the plan will run into heavy flak from many Democrats, who already are accusing the White House of turning its back on ordinary workers and allowing federal benefits for the unemployed to expire. The core of Mr. Kerry's economic plan, for instance, calls for the payroll-tax suspension dismissed by White House advisers. He also would raise the minimum wage and expand tax credits for the working poor, in addition to creating a number of tax incentives for business expansion and job creation. Even some Senate Republicans say the dividend-tax idea could run into political trouble.

In addition, the nation's highest-profile Democrat attacked President Bush's policies as ill-suited to the needs of a sluggish national economy. "The problem with the tax cut that was adopted [last year] is that it's too little stimulus in the short run and too little [fiscal] responsibility in the long run," former President Clinton told the Democratic Leadership Council in New York.